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Protection of the Environment in Investment Arbitration – A Double-Edged Sword

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The potential clash between protection of investors under investment treaties and protection of the environment has emerged in a number of recent arbitrations. More than 60 investment disputes filed since 2012 have had some environmental component. Amongst them, there have been several cases in which States have sought to enforce environmental law against investors in investment arbitration. On the flip side, there is also potential for investors to seek to enforce a State's environmental obligations through investment arbitration. This post explores the current state of play concerning protection of the environment and protection of investments, by examining the ways in which environmental laws and regulations might be used either by States or by investors in the context of investment arbitration disputes.

With respect to States enforcing environmental law against investors, the first possibility is that the State brings a counterclaim in proceedings commenced by an investor. There are five possible bases upon which an investment tribunal might find that it has jurisdiction over a counterclaim by a State against an investor.

First, the relevant treaty might explicitly provide for States to bring counterclaims. However, these are rare, and most treaties do not address the matter.

Second, an investment tribunal might consider that it has jurisdiction over counterclaims even in the absence of a specific treaty provision. Other international courts and tribunals have recognised the possibility of counterclaims. The International Court of Justice, the International Tribunal for the Law of the Sea and the Iran-US Claims Tribunal have all adopted procedural rules to adjudicate counterclaims, even though they are not explicitly provided for in their constituent instruments. That might provide a basis for investment tribunals to conclude that their jurisdiction extends to counterclaims even in the absence of an express grant of jurisdiction in the underlying investment treaty.

A third possibility is that the agreed arbitration rules permit counterclaims, and the parties' consent to those rules constitutes consent to a tribunal's jurisdiction over counterclaims. An example is Article 47 of the ICSID Convention, which provides that "except as the parties otherwise agree, the Tribunal shall, if requested by a party,

determine any … counterclaims arising directly out of the subject-matter of the dispute provide that they are within the scope of consent of the parties and are otherwise within the jurisdiction of the Centre." Other arbitration rules, such as the ICC Rules, the LCIA Rules, and the 2010 UNCITRAL Rules also provide for a respondent to make a counterclaim.[1)]

A fourth possibility is that the parties themselves consent to the tribunal taking jurisdiction over counterclaims. This occurred in the recent case of *Burlington Resources v Ecuador*, where Ecuador advanced a counterclaim alleging breaches of Ecuadorian environmental law and contractual obligations, seeking compensation of approximately $2.8 billion. While the proceedings were pending and after Ecuador presented its counterclaims with its Counter Memorial in January 2011, Burlington agreed not to contest jurisdiction over the counterclaim by a separate agreement entered into with Ecuador.[2)]

A fifth possibility is that the dispute resolution clause in a BIT may permit claims to be brought by a State. This was the interpretation given by an ICSID tribunal to the Argentina-Spain BIT in *Urbaser v Argentina*, and was one of the grounds on which it permitted a counterclaim by the State against the investor in that case.[3)]

Provided that a counterclaim is permissible, the question that then arises is: what is the source of the obligation? Here there are two possibilities.

The first is that the investor may be (and usually is) obliged to comply with domestic laws of the host State governing environmental protection. An investment contract may explicitly provide that an investor has to comply with applicable host State law; if there is no investment contract, the applicable BIT may require that the investment be made and maintained in accordance with host State law.

In two recent cases involving Ecuador, environmental counterclaims were brought by Ecuador on the basis of domestic environmental law. In Burlington v Ecuador, the ICSID tribunal awarded US$39.2 million to Ecuador for environmental harm caused by the investor in breach of the Ecuadorian statutory environmental regulation regime[4)] Burlington's partner in the same investment in Ecuador, Perenco, brought a second ICSID arbitration against Ecuador that has proceeded in parallel to the Burlington case. In that case, Ecuador also brought counterclaims in relation to Perenco's operation of its concession, and the effect of those operations on the environment. In a 2015 decision, the tribunal said that it was likely to hold Perenco liable for some contamination,[5)] but in the light of the significant disagreement between the party-appointed experts on the extent of contamination and Perenco's responsibility for it, the tribunal has appointed its own expert to investigate the relevant sites.[6)] In its decision, the tribunal encouraged the parties to attempt to settle the *dispute*.[7)] paras 593-594. *That appears not to have happened: the tribunal appointed an expert in mid-2016, but since then the claimant has filed an application to dismiss the counterclaims which remains pending before the tribunal.*

A second possibility for investor liability is on the basis of directly applicable

international law rules governing the environment. In the context of a counterclaim based on international human rights law, the tribunal in *Urbaser v Argentina* recently held that the investor could, in principle, be bound by international human rights obligations concerning the right to water.[8] It could thus be argued that investors are also directly subject to obligations arising from international environmental treaties. However, the difficulty with this argument is that most international environmental treaties which address the activities of non-State actors assume that State parties will establish a domestic institutional framework for their operationalization. For example, the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal obliges contracting State parties to enact legislation to establish a domestic regulatory regime.[9] It is difficult to read the provisions of that convention as establishing legal rights capable of enforcement against non-State actors. As a result it is unlikely that they are capable of imposing obligations directly on investors.

Turning then to the other side of the equation: can investment arbitration be used by investors to enforce the environmental obligations of States?

Here there are two possibilities. The first is that environmental treaties – as incorporated in host State domestic law – might be enforced by investors directly. Provided that the host State's laws impose obligations on the State in respect of environmental protection, an investor might be able to claim damages for the State's failure to comply with an environmental obligation where such failure has caused damage to a protected investment. In an UNCITRAL arbitration, *Allard v Barbados*, the claimant alleged that the State had not taken adequate measures to prevent environmental degradation impacting on its investment in an ecotourism facility. However, in the final award issued in late 2016, the tribunal dismissed the claims relating to the environment, finding that the claimant had not discharged its burden of proof.[10]

A second possibility is that an investor might formulate a claim for breach of an environmental norm – whether based in domestic law or in international law – by reference to one of the investment protection obligations in the treaty, such as fair and equitable treatment, or full protection and security.

In 2015, a majority of a NAFTA tribunal in *Bilcon v Canada* accepted an investor's arguments that Canada had breached Canadian environmental law, which also amounted to a breach of the minimum standard of treatment. The claim concerned a proposed quarry and marine terminal in the province of Nova Scotia. The allegations of breach focused on the handling of the lengthy environmental review project by a Joint Review Panel. Following the decision on liability, Canada has applied to its Federal Court seeking to set aside the award on jurisdiction and liability, on the grounds that the tribunal exceeded its jurisdiction and that the award is in conflict with the public policy of Canada. That challenge remains pending. In the context of environmental regulation, in a subsequent decision, the NAFTA tribunal in *Mesa v Canada* afforded a higher degree of deference to the respondent State in the implementation of regulatory measures, in the context of renewable energy.[11]

In the context of the full protection and security, the tribunal in *Allard v Barbados* suggested that a State's international environmental obligations "may well be relevant in the application of the [full protection and security] standard to particular circumstances", although it ultimately rejected the claimant's claim for breach.[12)]

These recent cases highlight the potential for environment law to be used as a sword by both States and investors in investment arbitration. But there have been few cases in which the basis of and limits to claims concerning environmental protection have been clearly articulated. Given the increasing number of cases involving some environmental component, it is likely that we will see these issues being addressed by investment tribunals in the near future.

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References

↑1 Rule 40(1) of the ICSID Arbitration Rules; Article 5 of the ICC Rules; Article 4 of the UNCITRAL Rules 2010; Article 2 of the LCIA Rules; Articles 4.1(b) and 25.2 of the SIAC Investment Arbitration Rules 2017.

↑2 *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Ecuador's Counterclaims, 7 February 2016, para 6.

↑3 *Urbaser v The Argentine Republic*, ICSID Case No. ARB/07/26, Award, 8 December 2016, para 1144.

↑4 *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Ecuador's Counterclaims, 7 February 2016, para 1075.

↑5 *Perenco Ecuador Ltd v Republic of Ecuador,* ICSID Case No. ARB/08/6, Interim Decision on the Environmental Counterclaim, 11 August 2015, para 582.

↑6 *Ibid,* paras 568-585.

↑7 Ibid, paras 593-594.

↑8 *Urbaser v The Argentine Republic,* ICSID Case No. ARB/07/26, Award, 8 December 2016, paras 1182-1192.

↑9 Article 4.4, Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal

↑10 *Peter A. Allard v The Government of Barbados*, PCA Case No, 2012-06, Award, 27 June 2016, para 110

↑11 *Mesa Power Group LLC v Government of Canada*, PCA Case No. 2012-17, Award, 24 March 2016, para 672.

↑12 *Peter A. Allard v The Government of Barbados*, PCA Case No, 2012-06, Award, 27 June 2016, para 244.

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